

LYNCHBURG CITY COUNCIL

Agenda Item Summary

MEETING DATE: **January 25, 2005, Audit Committee and Work Session**

AGENDA ITEM NO.: 1

CONSENT:

REGULAR:

CLOSED SESSION:

(Confidential)

ACTION:

INFORMATION: **X**

ITEM TITLE: Receive June 30, 2004 Annual Audit and Required Communications from the External Auditor

RECOMMENDATION: Receive the June 30, 2004 Comprehensive Annual Financial Report (CAFR, the "Audit") and required communications from the external auditor in accordance with the professional standards of the American Institute of Certified Public Accountants (AICPA) and the Code of Virginia.

SUMMARY: Brown Edwards and Company, LLP, (Brown Edwards), the City's external auditor has completed the audit of the City's financial records for the year ending June 30, 2004. In accordance with the professional standards of the AICPA and the Code of Virginia, there are certain required communications to the Audit Committee and City Council by the external auditor. Representatives from Brown Edwards will overview the following items and will be pleased to discuss any items in further detail:

1. Audit Committee Letter-Professional standards and the Code of Virginia require the external auditor to provide the Audit Committee and City Council information related to the audit. This information includes:
 - a. External Auditor responsibility under Auditing Standards accepted in the United States and OMB Circular A-133 which provides guidance to ensure compliance with requirements of major federal programs
 - b. Significant Accounting Policies
 - c. Accounting Estimates
 - d. Audit Adjustments
 - e. Disagreements with Management
 - f. Consultations with Other Independent Accountants
 - g. Issues Discussed Prior to Retention of Independent Auditors
 - h. Difficulties Encountered in Performing the Audit
2. Comprehensive Annual Financial Report (CAFR) - While the CAFR contains extensive financial information, the external auditor will not discuss the report in detail. The external auditor will discuss any findings and questioned costs required to be reported under Governmental Auditing Standards and compliance in accordance with OMB Circular A-133. This information can be found on pages 93-99 of the CAFR.
3. Management Letter-Comments on internal control and other suggestions that provide an opportunity for the City to strengthen internal controls an efficiency.

PRIOR ACTION(S): None

FISCAL IMPACT: None

CONTACT(S): L. Kimball Payne, III, City Manager
Michael W. Hill, Director of Financial Services

ATTACHMENT(S): Audit Committee Letter,
Comprehensive Annual Financial Report
Comments on Internal Control and Other Suggestions for Consideration (Management Letter)

Attachments in red can be viewed in the Office of the Financial Services Director, 3rd Floor, City Hall

REVIEWED BY: lkp

Members of City Council and City Manager
City of Lynchburg, Virginia

We have audited the financial statements of the City of Lynchburg, Virginia for the year ended June 30, 2004, and have issued our report thereon dated September 30, 2004. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America and OMB Circular A-133

As stated in our engagement letter dated May 28, 2004, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting standards generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants; noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2004. We noted the following transaction entered into by the City during the year that was both significant and unusual, and of which, under professional standards, we are required to inform you.

The City has issued long-term financing and is expending those proceeds for renovation of E. C. Glass High School. Through the use of a lease, a sublease, and the creation of a Limited Liability Partnership, the City will be able to share in the benefit of certain tax credits, resulting in reduced costs to the City.

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- The estimate of the total landfill closure/post-closure cost is based on external engineering estimates, modified by management.
- The estimate of the current landfill closure/post-closure liability is based on external engineering estimates of total capacity and capacity used to date, modified by management.
- The estimate of the useful lives of fixed assets is based on management's knowledge and judgment, which is based on historical experience.
- The estimate of self insurance liabilities is based primarily on estimates provided by third party providers.
- Management's estimate of the accrual of ambulance accounts receivable is based on historical averages of run fees and estimated runs not yet billed.
- The estimate of the allowance for uncollectible accounts for numerous accounts receivable is based on management's knowledge of the nature of the receivable and historical experience.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, the following audit adjustments we proposed, which were recorded by the City, either individually or in the aggregate, indicate matters that could have a significant effect on the City's financial reporting process. All amounts are rounded to the nearest thousand.

Prior Period Adjustments:

- \$173,000 to increase FY 2003 landfill closure/post-closure liability and decrease net assets to include costs required by the landfill permit, but improperly excluded by Solid Waste Management Division's management.
- \$512,000 to decrease landfill closure/post-closure liability and increase net assets as of June 30, 2003 for incorrect capacity used estimates provided by an external engineer.
- \$2,193,000 to increase beginning capital assets to record the City's 33.1% share in the Central Virginia Regional Radio System capital asset and the related accumulated depreciation, through June 30, 2003.
- \$344,000 to record City's 33.1% share in the Central Virginia Regional Radio System debt service reserve and other related investments.
- For governmental activities entity-wide purposes, \$737,000 of allowances for doubtful accounts recorded for fund statement purposes recorded as a reduction to beginning net assets.
- \$42,000 to record management's estimate of general liability claims payable at June 30, 2003. This liability was not recorded in prior years, therefore beginning fund balance, and related net assets for entity-wide purposes, were reduced.
- \$462,000 to increase beginning entity-wide net assets for ambulance accounts receivable accrual and related allowance account not recorded at June 30, 2003.
- \$258,000 relating to the June 30, 2003 return of funding from the Schools to the City. This amount was shown by the City as FY 2004 revenues, but should have been FY 2003 revenue.
- \$285,000 to increase compensated absences payable across multiple funds for inclusion of FICA taxes related to those compensated absences.
- \$323,000 to increase FY 2003 net assets and increase FY 2004 expenses of the Sewer and Internal Service Fleet Funds for capital asset additions expensed in FY 2003.
- \$136,000 to increase beginning fund balance, and beginning entity wide net assets, for franchise license tax not recorded.
- \$1,473,000 to decrease beginning net assets to record impairment of water dome capital asset at June 30, 2003.
- \$159,000 as an increase in beginning net assets for water dome construction costs expensed and should have been capitalized during FY 2003.
- \$808,000 to increase beginning net assets for dome insurance revenue that relates to dome capital asset impairment during FY 2003. Proceeds received in FY 2004 but earned in FY 2003 should be revenue in FY 2003.
- \$105,000 to increase beginning net assets for portion of workers' compensation liability recorded twice.

Current Year Adjustments:

- \$232,000 to record additional liabilities across multiple funds to account for health insurance claims incurred but not reported.
- \$53,000 to adjust workers' compensation claims payable to management's estimate of the liability.
- \$132,000 and \$142,000 respectively to correct water and sewer year end revenue accruals.
- \$32,000 to decrease June 30, 2004 landfill closure/post-closure liability for incorrect capacity used estimates provided by an external engineer.
- \$955,000 to increase accounts payable of numerous funds for unrecorded liabilities at June 30, 2004. Of these, approximately \$259,000 represents capital assets; \$57,000 capitalized at the fund statement level; and \$202,000 capitalized at the entity-wide reporting level.
- \$497,000 to record amounts due from state and federal funding agencies for reimbursement revenues as a result of recording additional accounts payable. This adjustment affected the City/Federal/State Aid Fund, the Community Development Block Grant Fund, the Comprehensive Services Act Fund, and the Airport Fund.
- \$437,000 to reduce current year accrual of ambulance accounts receivable at June 30, 2004.
- \$145,000 to record allowance for doubtful ambulance accounts receivable.
- \$55,000 to adjust solid waste accounts receivable allowance for doubtful accounts to management's estimate.
- Multiple adjustments totaling \$796,000 to record allowances for doubtful accounts and reduce deferred revenues. This adjustment affected the General Fund, the Community Development Block Grant Fund, the City Capital Projects Fund, the Highway Projects Grant Fund, the Water Fund, and the Sewer Fund.
- \$199,000 to record current year depreciation on the City's 33.1% share of the Central Virginia Regional Radio System capital asset.
- \$222,000 to record the capital lease payments made during FY 2004 towards the City's 33.1% share in the Central Virginia Regional Radio capital lease payable.
- \$19,000 to record City's 33.1% share in the Central Virginia Regional Radio System debt service reserve and other related investments FY 2004 activity.
- \$313,000 to record revenues due from State and Federal agencies for reimbursement of capitalized construction expenses for various CSO projects through June 30, 2004.
- \$82,000 to record an additional loss on disposal in the Water Fund for equipment that was depreciated for the year instead of being properly disposed as of June 30, 2003.
- \$209,000 to reduce gains shown as a result of the trade-in of numerous vehicles in the Internal Service Fleet Fund that should have been recorded as a decrease in the book value of the vehicles acquired.
- \$34,000 to reclassify water revenues recorded in the sewer fund.
- \$24,000 to record construction costs incurred but not recorded in the Water Fund at June 30, 2004.
- \$152,000 to record June 30, 2004 franchise tax receivable and related revenue.
- \$74,000 to reduce 2004 depreciation expense and related accumulated depreciation for water dome capital asset not disposed of in correct year.
- \$1,120,000 to capitalize water dome replacement recorded as an expense.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing our audit.

This information is intended solely for the information of management and the Lynchburg City Council. It is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
September 30, 2004